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Construction contractors industry developments - 2007/08; Audit risk alerts

American Institute of Certified Public Accountants. Auditing Standards Division

AUDIT RISK ALERTS

Construction Contractors Industry Developments — 2007/08

Strengthening Audit Integrity
Safeguarding Financial Reporting

American Institute of Certified Public Accountants

AICPA®

A U D I T   R I S K   A L E R T S

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Notice to Readers

This Audit Risk Alert is intended to provide auditors of financial statements of construction contractors with an overview of recent economic, industry, technical, regulatory, and professional developments that may affect the audits and other engagements they perform.

This publication is an *other auditing publication* as defined in AU section 150, *Generally Accepted Auditing Standards* (AICPA, *Professional Standards*, vol. 1). Other auditing publications have no authoritative status; however, they may help the auditor understand and apply the Statements on Auditing Standards.

If an auditor applies the auditing guidance included in an other auditing publication, he or she should be satisfied that, in his or her judgment, it is both relevant to the circumstances of the audit and appropriate. The auditing guidance in this document has been reviewed by the AICPA Audit and Attest Standards staff and published by the AICPA and is presumed to be appropriate. This document has not been approved, disapproved, or otherwise acted on by a senior technical committee of the AICPA.

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How This Alert Helps You

.01 This Audit Risk Alert (alert) helps you plan and perform your construction contractor audits. This alert can also be used by an entity's internal management to address areas of audit concern. This alert provides information to assist you in achieving a more robust understanding of the business, economic, and regulatory environment in which your clients operate. This alert is an important tool in helping you identify the significant risks that may result in the material misstatement of financial statements. Moreover, this alert delivers information about emerging practice issues and current accounting, auditing, and regulatory developments.

.02 This alert is intended to be used in conjunction with the AICPA *Audit Risk Alert—2007/08* (product no. 022338kk). This alert can be obtained by calling the AICPA at (888) 777-7077 or going online to www.cpa2biz.com. You should refer to the full text of accounting and auditing pronouncements as well as the full text of any rules or publications that are discussed in this alert.

.03 ***References to Professional Standards.*** When referring to the professional standards, this alert cites the applicable sections as codified in the AICPA *Professional Standards* and not the numbered statements, as appropriate. For example, Statement on Auditing Standards (SAS) No. 54, *Illegal Acts by Clients*, is referred to as AU section 317 of the AICPA *Professional Standards*.

Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement

.04 An auditor must obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risks of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures. An auditor's understanding of the entity and its environment consists of an understanding of the following aspects:

- Industry, regulatory, and other external factors
- Nature of the entity
- Objectives and strategies and the related business risks that may result in a material misstatement of the financial statements
- Measurement and review of the entity's financial performance
- Internal control, which includes the selection and application of accounting policies

.05 The construction industry may be subject to specific risks of material misstatement arising from the nature of the business, the degree of regulation, or other external forces (for example, political, economic, social, technical, and competitive forces).

.06 The auditor should obtain an understanding of the entity's objectives and strategies and the related business risks that may result in material misstatement of the financial statements. Business risks result from significant conditions, events, circumstances, actions, or inactions that could adversely affect the entity's ability to achieve its objectives and execute its strategies, or through the setting of inappropriate objectives and strategies. Just as the external environment changes, the conduct of the entity's business is also dynamic, and the entity's strategies and objectives change over time. An understanding of business risks increases the likelihood of identifying risks of material misstatement. However, the auditor does not have a responsibility to identify or assess all business risks. Most business risks will eventually have financial consequences and, therefore, an effect on the financial statements. However, not all business risks give rise to risks of material misstatement.

.07 After obtaining a sufficient understanding of the entity and its environment, including its internal control, an auditor should identify and assess the risks of material misstatement at the financial statement level and at the relevant assertion level related to classes of transactions, account balances, and disclosures based on that understanding.

.08 Understanding and properly addressing, as necessary, the matters presented in this alert will help you gain a better understanding of your client's environment, better assess risks of material misstatement of the financial statements, and strengthen the integrity of your audits.

Economic and Industry Developments

The State of the Economy

.09 When planning and performing audit engagements, an auditor should understand the economic conditions facing the industry in which the client operates. Economic activities relating to factors such as interest rates, consumer confidence, overall economic expansion or contraction, inflation, and labor market conditions are likely to have an impact on the entity's financial statements being audited.

.10 The U.S. real gross domestic product (GDP), the broadest measure of economic activity, measures output of goods and services by labor and property within the United States and increases as the economy grows. According to the Bureau of Economic Analysis, GDP increased at an annual rate of 2.9 percent in 2006, consistent with the pace of growth experienced in 2005 when GDP increased by 3.1 percent. During the first quarter of 2007, GDP increased by an annual rate of only 0.6 percent. However, according to second quarter preliminary estimates, GDP increased at an annual rate of 4.0 percent.

.11 The unemployment rate remained relatively unchanged during 2006, holding between 4.4 percent and 4.8 percent, with an annual average rate of 4.6 percent representing approximately 7 million people. The 2006 rates represent the lowest annual rate and total number of jobless since 2000, according to the U.S. Department of Labor, Bureau of Labor Statistics. During the first half of 2007, the unemployment rate averaged 4.5 percent. These data further demonstrate the economic growth the United States has experienced since the beginning of 2006.

.12 After a period of rising rates during the first half of 2006, the Federal Reserve kept its target for the federal funds rate at 5.25 percent for 10 consecutive meetings (June 2006–August 2007). At that time, the Federal Reserve indicated future federal fund rate adjustments would likely depend upon the outlook for economic growth and inflation. Since its August 2007 meeting and in response to shaky financial market conditions, the Federal Reserve has taken several action steps. It announced that it would provide reserves as necessary through the open market to facilitate the orderly functioning of financial markets by promoting trading in the federal funds market at rates close to the 5.25 percent target rate. On August 17, 2007, it announced that financial market conditions had deteriorated and tighter credit conditions and increased uncertainty have the potential to restrain economic growth. Then at its September meeting, the Federal Reserve decided to lower its target for the federal funds rate 50 basis points to 4.75 percent citing increased uncertainty surrounding the economic outlook. The Federal Reserve also decided to decrease the discount rate 50 basis points to 5.25 percent to consistently keep the spread between the primary credit rate and the target federal funds rate at 50 basis points. Auditors should remain alert to developments in the financial markets and how they may affect your audit engagements.

Industry Trends and Conditions

.13 Despite continued weakness in the residential sector, there have been solid gains in most nonresidential construction sectors so far, and robust conditions are expected to continue for the remainder of the year. The American Institute of Architects (AIA) Consensus Construction Forecast Panel projects growth of 7.2 percent in nonresidential construction activity (after inflation adjustments) for 2007, with an almost 9 percent jump in commercial activity, and a healthy 5.4 percent increase in institutional facilities. They are projecting to see much slower gains in 2008, but gains nonetheless. Commercial construction is expected to edge up another 1.1 percent, with institutional activity growing by 4.5 percent, producing an almost 3 percent gain in total activity for 2008.

.14 However, there is a growing list of concerns in the economic outlook. The housing market continues to deteriorate and is not only slowing the economy directly, but may cause consumers to decrease spending as a result of their anxiety about falling home prices. Also, there is growing concern that inflation may begin to accelerate in our economy. High oil prices continue to add pressure to inflation, and long-term interest rates have begun to trend up recently. Inflation in building commodity prices has been a major source of disruption to the construction industry in recent years, but fluctuations in commodity prices have fortunately begun to moderate recently.

.15 Though most members of the AIA Consensus Construction Panel were expecting a good year for nonresidential construction in 2007, so far this year activity has largely exceeded even the most optimistic outlooks. Although total construction spending slipped 0.4 percent in July (seasonally adjusted) and residential fell 1.4 percent, nonresidential spending climbed 0.6 percent (the tenth consecutive monthly gain). For the first seven months of 2007 combined, total construction was down 3.4 percent, and residential plummeted 18 percent compared to the same period in 2006. Those figures obscure the 15 percent jump in nonresidential spending.

Construction Put in Place

.16 One of the most widely used measures of construction activity is construction put in place, which is tracked monthly by the Bureau of Statistics at the U.S. Department of Commerce. The value of construction put in place is a measure of the value of construction installed or erected at the site during a given period. For an individual project, this includes the following:

- New buildings and structures
- Additions, alterations, major replacements, and so on to existing buildings and structures
- Installed mechanical and electrical equipment

- Installed industrial equipment, such as boilers and blast furnaces
- Site preparation and outside construction, such as streets, sidewalks, parking lots, utility connections, and so on
- Cost of labor and materials (including owner-supplied)
- Cost of construction equipment rental
- Profit and overhead costs
- Cost of architectural and engineering work
- Any miscellaneous costs of the project that are on the owner's books

.17 The total value of construction put in place for a given period is the sum of the value of work done on all projects underway during this period, regardless of when work on each individual project was started or when payment was made to the contractors. For some categories, estimates are derived by distributing the total construction cost of the project by means of historic construction progress patterns.

.18 The following table presents details of construction put in place for various market segments. Note that the amounts are in billions of dollars and represent seasonally adjusted annual rates.

New Construction Put in Place

(Billions of Dollars—Seasonally Adjusted Annual Rate, in Current Dollars)

	July 2007	*July 2006*
Private construction	$880.1	$930.9
Public construction	289.0	269.1
Total construction	**$1,169.1**	**$1,200.0**
Nonresidential building		
Office	$53.9	$45.1
Power	37.7	34.7
Commercial	82.4	77.2
Lodging	29.3	21.0
Other nonresidential	142.7	125.5
Total nonresidential	346.0	303.5
Residential building	534.1	627.4
Total private construction	$880.1	$930.9
Highways and streets	$74.3	$76.6
Infrastructure	39.7	36.9
Educational	83.0	69.9
Other public buildings	33.8	24.6
Other public construction	58.2	61.1
Total public construction	$289.0	$269.1

.19 The U.S. Census Bureau of the Department of Commerce announced that construction spending during July 2007 was estimated at a seasonally adjusted annual rate of $1,169.1 billion (0.4 percent below the revised June 2007 estimate of $1,173.2 billion). The July figure is 2.0 percent below the July 2006 estimate of $1,192.9 billion. During the first 7 months of this year, construction spending amounted to $657.7 billion (3.4 percent below the $680.9 billion for the same period in 2006).

.20 Spending on private construction was at a seasonally adjusted annual rate of $880.1 billion (0.7 percent below the revised June 2007 estimate of $886.3 billion). Residential construction was at a seasonally adjusted annual rate of $534.0 billion in July (1.4 percent below the revised June estimate of $541.8 billion). Nonresidential construction was at a seasonally adjusted annual rate of $346.0 billion in July (0.4 percent above the revised June estimate of $344.5 billion).

.21 In July 2007, the estimated seasonally adjusted annual rate of public construction spending was $289.0 billion (0.7 percent above the revised June estimate of $287.0 billion). Educational construction was at a seasonally adjusted annual rate of $83.0 billion (1.9 percent above the revised June estimate of $81.5 billion). Highway construction was at a seasonally adjusted annual rate of $74.3 billion (0.8 percent below the revised June estimate of $74.9 billion).

Help Desk—You can access current statistics of construction put in place and other construction industry information at www.census.gov.

Private Construction

Residential Building

.22 The residential building segment of the construction industry includes new single- and multifamily housing as well as residential repairs and improvements. Conditions that have the most effect on the demand for residential construction include the following:

- *Housing affordability.* Housing affordability is the extent to which potential buyers have the means to purchase a home. Affordability can be measured in several ways by considering average home prices and income levels. For example, some analysts create an "affordability index" by comparing median home prices to household income levels. As income levels get closer to housing prices, the average home becomes affordable to more local residents.
- *Interest rates.* Most homes are financed, and interest rates therefore have a tremendous effect on the affordability of housing. As interest rates rise, the cost of home financing increases; as they fall, the cost of financing decreases. However, interest rate changes do not have an immediate impact on home-buying markets—usually rates must be in effect for several quarters to reverse home-buying trends.
- *Land availability and pricing.* Because land is one of the major costs of residential building, land availability and pricing have a major effect on the affordability of housing. Housing prices will be

affected as land suitable for residential building becomes scarce in certain parts of the country.

- *Demographics.* Shifts in demographics can have a significant effect on housing demand. For example, the aging of the U.S. population has increased demand for low-maintenance and multifamily housing. A large number of baby boomers are now entering their peak earning years, which is expected to affect the affordability and demand for single-family homes.
- *Market velocity.* According to industry sources, more than half of all home improvements occur within 18 months after a new owner moves in, or within 12 months before the home is sold. Thus, during times when new and used home markets are active, residential remodeling and improvement activity also increases.

.23 Housing starts have stabilized so far in 2007 at just below 1.5 million units, but job-site spending has declined about 1 percent per month, reflecting slower completion of homes and cutbacks in home size and amenities in a depressed sales market. Some industry analysts believe housing starts are near the bottom for this cycle, although one or two lower monthly starts reports are possible. Further, some believe recovery will be slow, held back by an oppressive overhang of inventory of homes for sale, which are mostly existing homes.

.24 All of the other usual drivers in the housing market are neutral to slightly positive and are expected to improve through 2008. A leading business information firm, Reed Construction Data, forecasts that about 40 percent of the 2006–2007 drop in housing starts will be recovered by the end of next year. This would still leave starts well below the underlying demographic trend demand (that is, population and household growth and shifts). Such an anticipated recovery requires the forecasted return to 3.0 percent real GDP growth, so that the inventory surplus is absorbed almost as quickly as it appeared. However, other housing forecasts are generally less optimistic.

Nonresidential Building

.25 The boom in nonresidential building construction continues but is showing signs of peaking. Construction spending is now 15 percent higher for the first 7 months of 2007 than for the same period in 2006, and the value of starts is up 22 percent. Over that period, starts are up 29 percent for commercial buildings, 10 percent for institutional buildings, and have doubled for manufacturing facilities.

.26 For-lease buildings remain the construction market with the fastest growth. Year-to-date starts are up 55 percent for hotels, 46 percent for offices, 27 percent for stores, and 25 percent for warehouses. Job-site construction spending for these buildings is up 24 percent year-to-date, and analysts expect continued growth at about this pace or perhaps a little faster. These investment buildings continue to be attractive to the financial market, although analysts expect their relative attractiveness to ebb over the next year as completions rise and restrain increases in rents and occupancy rates.

Public Construction

.27 Public construction was up 0.7 percent in July 2007 and 11 percent year-to-date. The biggest component, education, rose 1.9 percent in July 2007 and 12 percent year-to-date. However, highway and street construction, which received a big boost in late 2005 and early 2006, was down 0.8 percent for the month of July 2007 and was only 5 percent higher year-to-date. That partly reflects lower prices for diesel and asphalt, but it also shows that states are running short of highway funds as gas tax receipts slow. Accordingly, highway spending could drop sharply in late 2008. In August 2007, the Congressional Budget Office projected a $5 billion deficit in the federal Highway Trust Fund's Highway Account in fiscal year 2009. Congress will need to bridge that gap to keep road spending from plunging.

.28 The growth pace for institutional contracts has slowed due to the sharp decline in tax-receipt growth over the last several quarters and the accompanying drop in public budget reserves. The tax situation is now reversing in a stronger economy, so no further drop in the growth of institutional starts is expected. Healthcare is the strongest area of the institutional sector because it is less dependent on tax receipts.

Surety Industry Trends

.29 The surety industry is critical to the well-being of the construction industry. Nearly half of all work performed by construction contractors is bonded, so any change in the surety market will have a significant effect on the construction industry. The surety bond market is continuing to make a slow recovery. As the economy improves, bonding companies are loosening up on the self-preservation safeguards imposed when the reinsurance market plummeted.

.30 Reinsurance allows a bonding company to spread its risk among special reinsurance markets, lessening the effect of claims on any one company. That market still has not fully recovered, leaving fewer reinsurance companies available for bonding companies to spread risks. As a result, sureties offering performance and payment bonds are more selective in allocating their capacity and have less tolerance for underperforming or risky clients.

.31 Bonding companies are more judicious in that they are choosing clients with stronger financial margins and high quality accounting presentations in both internal and external reporting. Coming out of a "hard" market, sureties are still cautious, which means contractors often feel the consequences.

.32 Construction contractors that work for private sector owners may often secure a job on a handshake, but contractors doing hard-bid work for public agencies are required by law to be bonded. Larger contractors may have trouble bonding projects over $100 million due to the reinsurance market. Contractors sometimes find that the bonding capacity just is not available for larger sized projects. In these cases, it may take the involvement of several surety companies to secure the required bonding.

.33 In an attempt to avoid high bond premiums and potentially time-consuming and expensive investigations, some contractors are turning to an alternative form of protection against subcontractor default. Contractor default insurance (CDI) is a policy that replaces traditional subcontractor bonds. A construction contractor purchases the policy, which obligates the insurer to reimburse the contractor for costs related to subcontractor default. The subcontractors are added to the contractor's policy instead of requiring them to post bonds.

.34 The advantages of an insurance policy over traditional bonds are lower premium costs and a greater flexibility in addressing and resolving subcontractor defaults. Because a surety is entitled to conduct a routine and often time-consuming investigation in the case of a default, a CDI may bring a more timely response to the problem. A contractor can remedy a situation by using its own forces or by hiring a new subcontractor as soon as a subcontractor defaults and then immediately submitting the costs for later reimbursement.

.35 On the other hand, there is no contractual obligation under a CDI policy for an insurer to step in and complete a subcontractor's work, unlike a bonding company. The CDI underwriter also has no payment obligation to a subcontractor or its suppliers the way a bonding firm would. The construction manager assumes these risks and is held to the terms and conditions of the insurance policy. When a loss is reimbursed, the payout is subject to typically large deductibles, copayments by the insured, and strict project-specific and overall loss limits.

Construction Cost Trends

.36 From early 2004 to mid-2006, the construction industry was plagued by runaway materials cost increases. Many of these price increases have slowed or even reversed course modestly in recent months. Unfortunately, it seems likely that the current calm is only a lull between storms and not a return to the inflation-free period of 2001–2003. However, economists at the Associated General Contractors of America (AGC) and McGraw-Hill Construction say contractors can expect a better year for most materials, despite uncertainties about fuel prices. However, unknowns include how much pressure on materials and prices will be eased by the housing slowdown, how the tighter immigration policies in some states will affect the labor market, and what will happen in Congress.

Asphalt

.37 According to AGC, the biggest concern in materials for 2007 and beyond is probably asphalt. Asphalt was in short supply in 2006, and prices spiked as high as 30 percent in some areas. Colorado, Hawaii, and Wyoming experienced some of the worst shortages. This same scenario could play out again because many refineries are planning to install new cokers and eliminate the residual that has been sold as asphalt. Construction contractors need to work closely with their asphalt suppliers regarding upcoming changes in the source and availability of the supply and be prepared to look further afield. This will be an evolving situation even beyond 2007. Other refineries might decide to supply markets they had not been serving before as they adjust their product lines to maximize profit levels.

Copper

.38 Economists at both AGC and McGraw-Hill expect copper prices to remain elevated. Construction contractors buying pipe or wire can expect only slight fluctuations in prices. Contractors must also be mindful of widespread thefts and vandalism of copper products from storage and building sites. There is some potential for a price decrease as a result of the lower demand in the housing market. Overall, copper prices will continue to be high in 2007.

Steel

.39 Steel should be widely available this year; however, concern over the demand from China continues to exist. There have been some impressive increases in China's own industrial capacity, and contractors should monitor this situation to gauge the effect on the steel market in 2007 and beyond.

Cement

.40 Cement supply has been a troublesome area in the past but will probably be less so in the future. There has been an expansion of the domestic supply, which should continue, as well as continued increase in supply from Mexico. Price increases should be moderate, perhaps somewhere around 3 percent to 5 percent.

Gypsum

.41 According to economists at AGC and McGraw-Hill, the sharp decline in housing and remodeling construction will make for significantly lower demand for gypsum. Gypsum prices were up approximately 20 percent in 2006 but only 3 percent to 4 percent in 2007. The further good news is that prices for gypsum should actually decrease in the future, maybe even as much as 10 percent to 20 percent, as demand drops.

Fuel

.42 According to McGraw-Hill, the price pressures will not be as extreme in the future as in the current environment. The likelihood of any sharp decline in prices is remote. A slowing U.S. economy and less demand could affect prices this year, but the fuel market is a difficult market to predict. There is significant volatility and a multitude of factors that affect fuel supply and consequently pricing, including strikes, weather, wars, and political instability.

Construction Plastics

.43 The supply of PVC pipe was very tight after the hurricanes in late 2005, and prices increased 5 percent in 2006. However, prices should be flat or even slightly lower for construction plastics in 2007 and beyond, according to AGC. In addition, there is ample supply, primarily because the decrease in home building is reducing demand pressures on existing suppliers.

Legislative and Regulatory Developments

Three Percent Withholding Tax

.44 In 2012, a new law will require federal, state, and local governments to withhold 3 percent from all payments for goods and services as a guard against possible business tax evasion. This far-reaching new requirement was inserted as a last-minute revenue raiser into the Tax Reconciliation Act of 2005 that was signed by the President in May 2006. The law does the following:

- Requires withholding of 3 percent on all government payments for products and services made by the federal, state, and local governments with total expenditures of $100 million or more
- Affects payments for goods and services under government contracts as well as payments to any person for a service or product provided to a government entity (for example, Medicare and certain grants)

.45 According to a 2006 Construction Financial Management Association Survey, construction companies make, on average, 2.2 percent per contract. If this law is implemented, the government may withhold more than the profit from every contract, in theory to pay for business taxes. This over-withholding may result in severe cash flow deficiencies, increased costs for bonding and lowered bonding capacity, and possibly bankruptcies.

.46 For example, if a small business contractor holds one government contract estimated to be completed in one year for $10 million, this law requires withholding of $300,000 on that contract. Meanwhile, the contractor expects to net approximately 2.5 percent, or $250,000, after paying for supplies, services, subcontractors, and other ordinary business expenses. The tax on the revenue generated is at most 35 percent of the revenue, which means the maximum tax owed on the $10 million project is $87,500 (35 percent of $250,000). Ultimately, the government has withheld $300,000 for $87,500 in tax liability.

.47 A number of construction-related organizations are working to have this section of the Tax Reconciliation Act of 2005 repealed.

Audit and Attestation Issues and Developments

Auditing Construction Contracts

.48 As we mentioned in the first part of this alert, in the construction industry, business conditions vary greatly across construction sectors and from region to region. Risks associated with erecting schools are different from those faced by a homebuilder. Likewise, a contractor in the Northwest may face different issues than a similar contractor on the Gulf Coast. For this reason, auditors must be knowledgeable about the types of construction contracts that contractors use and the regions in which the entity operates.

.49 The financial statements of a contractor are built from the financial results of individual contracts. Therefore, an effective audit approach focuses on the terms, financial estimates, and results of individual contracts rather than on the contract-related balance sheet that accounts for the entity as a whole.

.50 To obtain a general understanding of the nature of a construction contractor's operations, you should review the terms of a representative sample of the contractor's contracts, including significant contracts that are currently in force. This sample should include both contracts with customers and contracts with subcontractors. Information that you would expect to find in the contracts includes the following:

- Job number
- Type of contract
- Contract price
- Original cost estimate and related gross profit
- Billing and retention terms
- Provisions for changes in contract prices and terms, such as escalation, cancellation, and renegotiation
- Penalty or bonus features relating to completion dates and other performance criteria
- Bonding and insurance requirements
- Location and description of project

.51 The authoritative guidance on auditing contractors is contained in the AICPA Audit and Accounting Guide *Construction Contractors* (product no.

012587kk). Included in this Audit and Accounting Guide is Statement of Position (SOP) 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* (AICPA, *Technical Practice Aids*, ACC sec. 10,330), which is the primary authoritative accounting guidance for construction contractors.

Fixed-Price Contracts

.52 A fixed-price contract is generally considered the riskiest for both the contractor and the auditor. As the riskiest contract type in an audit, you must employ all of your available audit tools to verify the total contract amount, the collectibility and likelihood of contract changes, and the status of the contract as of the balance sheet date. Auditing procedures related to revenue for this type of contract may consist of the following:

- Confirming contract terms and status
- Testing the contractor's business functions over estimating, billing, collection, project management, and generally all controls that influence the contractor's ability to manage estimates
- Testing the contractor's subsequent performance
- Measuring the contract job gain or fade trends by comparing the contractor's ability to estimate by using original estimated contract revenues and costs and comparing these figures to period end amounts and final contract amounts for a period of several years
- Using other analytical procedures

Cost-Type Contracts

.53 Cost-type contracts present a lower level of risk. With this type of contract, the audit procedures should be focused on the contract provisions concerning the definition of contract costs and the associated revenue entitlements of the contractor. If the contract clearly defines allowable costs, overhead calculations and allocations, agreed-upon profit, and payment terms, the auditor's job is easier and can then be focused on the realization of collection and the creditworthiness of the owner. There are many variations of the cost-type contracts that present various degrees of concern and additional audit requirements for the auditor.

Time and Material Contracts

.54 Time and material contracts also present lower risk revenue issues for the auditor as long as the contractor has identified all of its costs, including its overhead costs, and has defined its required gross profit. The audit focus in this type of contract comes back to the contractor's internal controls and the ability to fully identify and capture its costs—direct, indirect, and overhead. Auditing procedures that can be employed could include internal controls testing and subsequent billings and collections of the outstanding time and material costs as of the period end.

Unit-Price Contracts

.55 Unit-price contracts are often variations of fixed-price contracts. Under a unit-price contract, the contractor knows the amounts that will be due as each unit is performed. Audit procedures in this area may consist of the following:

- Verifying the work performed with outside parties through the use of confirmations, including the terms of the contract
- Verifying the terms of the contract concerning the provisions for unit prices, their amounts, and contract billing terms by examining the contract
- Determining the revenue balance available to be performed and billed under the contract

.56 Other procedures to be applied may be similar to the procedures applied to fixed-price contracts.

Service Contracts

.57 Service contracts can include a blend of other contract types, such as time and material. You should separate these other contract type elements and perform the appropriate testing under those categories. A service contract can consist of labor only or labor and material. The terms of the contract should be reviewed for the risks that the contract presents to the contractor and the audit. For example, does the contract cover maintenance only with breakdowns covered at fixed time and material rates and costs? The risk of loss on such a contract would be minimal. On the other hand, does the service contract provide for the provision of a guaranteed service, such as uninterrupted power (which may be necessary for the function of a hospital)? This type of contract would require more extensive auditing procedures that would involve auditing the contractor's ability to produce reliable estimates similar to a fixed-price contract. If a service contract has only provisions for maintenance and the minimal supply of parts, the revenue auditing procedures may consist of the following:

- Scheduling the earned and unearned parts of the contract and recording the unearned part as deferred revenue.
- Examining the contractor's system that tracks the performance of the required or contractual provision of periodic services, if any, to see that they have been performed. This could result in a liability that would need to be measured.
- Determining whether the contractor has the ability to cost each service contract to determine whether the service contract requires a loss reserve.
- Testing the service revenues and costs analytically to see if the gross profit earned is typical compared to industry averages.
- Testing the contractor's prior ability to estimate with reasonable certainty. Service contracts that have provisions that require estimates should be tested in a manner similar to a fixed-price contract.

Construction Management Contracts

.58 Construction management contracts can also be a blend of the various types of contracts described and defined in the previous sections. The particular attributes or details of the contract should be examined to see if these other attributes exist. For example, the contract may call for the contractor to act as agent under a fee arrangement but permit it to perform certain parts of the construction if it deems that it can perform the work for five percent less than the lowest bidder. The construction part will need to be tested and audited as a construction contractor. The audit risk that a construction management contract presents will depend on the contract terms. If a construction management contract calls for a fee based upon a percentage of costs, audit risk is lower. On the other hand, if the construction management contract fee is a fixed price, you will need to examine the revenue recognition methods and test the progress to date. For example, if a contractor estimates that it will take 1,000 man-hours to earn the construction management fee of $500,000 over an 18-month period, you can examine the hours performed to date and the estimate of the hours to complete. In addition, the calculation of hours to date to total estimated hours can be compared to the physical estimate of percentage of completion for reasonableness. Testing of the contractor's internal controls and prior ability to estimate with reasonable certainty can also be used to gather audit evidence.

Design-Build

.59 The design-build contract is a new type of contract and is continuing to be an increasingly popular vehicle for contract performance. The audit risk involved in this type of contract focuses on the detail of the contract terms. Is the contractor going to be reimbursed for its costs under a cost-type arrangement? Is the contract broken out into various pieces where the contractor bids separately on the design and construction work in different phases? The answers to these questions and other facts and circumstances may lead you to make judgment calls about the appropriateness of the use of audit procedures described under the contract types listed in the previous sections. If a design-build contract outcome is uncertain, you should consider whether the contract should be accounted for under alternative revenue recognition methods such as zero profit or the completed-contract method until measurements are reliable and more certain.

Contracts With Incentive Provisions

.60 All the contract types described in the previous sections may have provisions for incentives. The audit of a contract that includes incentive provisions may consist of the following procedures:

- An examination of the contract terms to determine the conditions for incentive achievement
- A test to see if the conditions for achievement have been met
- Confirmation of incentive earnings
- Subsequent billing and collection of incentive revenues
- Analysis of whether incentive provisions can be earned incrementally or are under "all or none" terms
- A determination of whether the incentive should be considered a gain contingency properly accounted for under Financial Accounting Standards Board (FASB) Statement No. 5, *Accounting for Contingencies*

Using Hedging Transactions to Manage Risk

.61 Many construction contractors enter into hedging transactions to manage various risks. The most common risks that lend themselves to hedging strategies include those related to interest rate or foreign currency exposures. Construction contractors may also enter into weather derivative contracts (that is, contracts indexed to climatic or geological variables). FASB Emerging Issues

Task Force (EITF) Issue No. 99-2, "Accounting for Weather Derivatives," prescribes the accounting treatment for weather derivatives.

.62 FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, provides the primary guidance on accounting for hedging transactions. In addition, you should be familiar with AU section 332, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* (AICPA, *Professional Standards*, vol. 1), and the AICPA's Audit Guide *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* (product no. 012527kk), which provides practical guidance to accompany AU section 332. The guide includes an overview of derivatives and securities and how various entities use them, a summary of accounting guidance, and a discussion of the three elements of the auditing framework: inherent risk, control risk, and substantive procedures. Additionally, the guide includes practical illustrations and case studies.

.63 If your client holds derivative instruments or engages in hedging transactions, you should become thoroughly familiar with the authoritative accounting and auditing literature relating to derivatives.

Debt Covenants

.64 Loan terms, including covenants, are worthy of special attention for audits of construction contractors. Violation of a loan covenant can have a material effect on the financial statements and on the organization's ability to continue operations. You should carefully review loan agreements and test for compliance with loan covenants. In this regard, consider any "cross default" provisions, which are violations of one loan covenant that affect other loan covenants. Keep in mind that any debt with covenant violations that are not waived by the lender for a period of more than one year from the balance sheet date may need to be classified in the balance sheet as a current liability.

.65 As always, review the debt payment schedules and consider whether the company has the ability to pay current debt installments or to refinance the debt if necessary. When making an evaluation, it is important to remember that it is quite possible that the company may not generate as much cash flow as it did in previous years due to current economic and industry conditions.

Auditing Estimates

.66 Remember that the audit of a construction contractor's financial statements is essentially an audit of the contractor's ability to estimate. Therefore, it is critical that you gain an understanding of the contractor's significant estimates and assumptions that are used in operating the business. AU section 342, *Auditing Accounting Estimates* (AICPA *Professional Standards*, vol. 1), provides a list of procedures that serve as a good basis for auditing the estimates found in a construction contractor's financial statements.

.67 In many situations, the auditor assesses the reasonableness of an accounting estimate by performing procedures to test the process used by management to make the estimate. The following are procedures the auditor may consider performing when using this approach:

a. Identify whether there are controls over the preparation of accounting estimates and supporting data that may be useful in the evaluation.

b. Identify the sources of data and factors that management used in forming the assumptions, and consider whether such data and factors are relevant, reliable, and sufficient for the purpose based on information gathered in other audit tests.

c. Consider whether there are additional key factors or alternative assumptions about the factors.

d. Evaluate whether the assumptions are consistent with each other, the supporting data, relevant historical data, and industry data.

e. Analyze historical data used in developing the assumptions to assess whether the data is comparable and consistent with data of the period under audit, and consider whether such data is sufficiently reliable for the purpose.

f. Consider whether changes in the business or industry may cause other factors to become significant to the assumptions.

g. Review available documentation of the assumptions used in developing the accounting estimates and inquire about any other plans, goals, and objectives of the entity, as well as consider their relationship to the assumptions.

h. Consider using the work of a specialist regarding certain assumptions (AU section 336, *Using the Work of a Specialist* [AICPA, *Professional Standards*, vol. 1]).

i. Test the calculations used by management to translate the assumptions and key factors into the accounting estimate.

.68 Based on the auditor's understanding of the facts and circumstances, he may independently develop an expectation as to the estimate by using other key factors or alternative assumptions about those factors.

.69 Events or transactions sometimes occur subsequent to the date of the balance sheet, but prior to the date of the auditor's report, that are important in identifying and evaluating the reasonableness of accounting estimates or key factors or assumptions used in the preparation of the estimate. In such circumstances, an evaluation of the estimate or of a key factor or assumption may be minimized or unnecessary as the event or transaction can be used by the auditor in evaluating their reasonableness.

Using the Work of a Specialist

.70 It may be necessary to use a specialist (such as construction engineer) to perform or assist in job site visits or other audit procedures. The specialist may help you gain assurance as to the percent complete, identify problems on the job, and identify possible uninstalled materials or inventoriable items. In addition, the specialist will generally be able to communicate effectively with job site personnel.

.71 Engaging a specialist for gaining an understanding of internal controls, tests of controls, substantive tests, and analytical procedures requires awareness of guidelines available in the authoritative literature. According to paragraph .06 of AU section 336, specialized assistance is advisable for auditors who

> ...may encounter complex or subjective matters potentially material to the financial statements. Such matters may require special skills or

knowledge and in the auditor's judgment require using the work of a specialist to obtain appropriate audit evidence.

.72 Involvement of a specialist should be considered during audit planning because of the lead time necessary to contract for a specialist's services and the time required for you to obtain the minimum knowledge necessary to supervise the specialist. According to paragraph .10 of AU section 311, *Planning and Supervision* (AICPA, *Professional Standards*, vol. 1),

> If specialized skills are needed, the auditor should seek the assistance of a professional possessing such skills, who may be either on the auditor's staff or an outside professional. If the use of such a professional is planned, the auditor should have sufficient computer-related knowledge to communicate the objectives of the other professional's work; to evaluate whether the specified procedures will meet the auditor's objectives; and to evaluate the results of the procedures applied as they relate to the nature, timing, and extent of other planned audit procedures. The auditor's responsibilities with respect to using such a professional are equivalent to those for other assistants.

.73 The use of a specialist is an excellent way to learn the construction contractor's business and can be helpful from initial planning through site visits and fieldwork.

Going Concern

.74 Business failure among construction contractors is common for many reasons. The construction industry is complex and requires a great deal of planning and organization, especially when dealing with long-term contracts and labor and materials issues that are dictated by forces external to the entity. The volatility of the housing market has compounded that problem over the past year and will continue to be an issue in the coming years. Some examples of indicators that there could be substantial doubt about the ability of the entity to continue as a going concern include the following:

- Negative trends such as recurring operating losses, working capital deficiencies, or negative cash flows from operating activities
- Other indications of possible financial difficulties such as loan covenant violations or denial of usual trade credit from suppliers and denial of surety credit
- Internal matters such as labor difficulties; turnover in key positions such as CFO, controller, or project managers; or substantial dependence on the success of a particular project
- Lack of significant backlog to cover overhead
- External matters such as legal proceedings or an uninsured catastrophe

.75 In addition to these matters, the current uncertain economic situation may cause you to have a heightened sense of awareness of a company's ability to continue as a going concern. AU section 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, *Professional Standards*, vol. 1), addresses the auditor's responsibilities to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern.

.76 Consider testing to see if the gross profit in the backlog will be sufficient to carry the company through the remainder of the next fiscal year. You should be careful in this evaluation if the client's history indicates significant gross profit fade. If this is the case, the analysis should be discounted when making an overall evaluation of the entity's ability to continue as a going concern.

.77 Many contractors are seeing very large increases in their insurance rates. Some contractors cannot obtain commercial general liability insurance or find that it is available from only one or a few carriers. Such situations will affect the contractor that has a long-term contract bid initiated when insurance rates were lower and could call into question the going-concern assumption for a contractor that cannot obtain insurance.

.78 Also be aware of other issues that may affect the entity's ability to continue as a going concern, such as the following:

- *Inadequate capitalization.* Although many construction contractors have an understanding of the amount of capital that is required to start their businesses, some fail to take into account the funds that will be required to sustain the new companies until cash begins to flow in. Adequate working capital, typically 5 percent to 10 percent, and the ability to obtain additional bank financing when needed are signs that a contractor has sufficient resources to support operations. Additionally, the use of short-term financing affects working capital calculations. Using this type of financing to purchase assets with long cost recovery periods, such as construction equipment, might absorb cash needed for current operations and can result in reduced surety bonding capacity.
- *High employee turnover.* A construction company cannot succeed without experienced estimators, project managers, and superintendents. Familiarity with the company's strengths and resources improves the accuracy of bids and improves the likelihood of completing projects within budget and profit projections. Turnover in these positions can result in underbidding of jobs and lower job profitability through inefficient use of resources.
- *New types of projects.* In the same way that you would not expect a cardiologist to perform brain surgery, each construction specialty area requires a skill set that is specific to that type of project. When contractors venture into new areas (for example, a highway contractor decides to build an office building), new business risks and issues arise that may affect performance and profitability.
- *Increase in job size.* New risks and challenges arise when contractors bid on jobs that are substantially larger than their normal jobs. A $5 million project is much more complex than a $500,000 job in terms of the resources, knowledge, and project management skills required.
- *New geographic areas.* A contractor in South Carolina faces different issues than a contractor in Montana. It is more difficult to manage a contract in a region of the country that you are not familiar with. In addition, there may be issues with finding an adequate labor supply; assessing the quality of subcontractors available in that area; establishing relationships with new suppliers; learning and complying with local codes and regulations, lien laws, and tax laws; and becoming familiar with differences in weather and site conditions.

- *Rapid growth.* Taking on too many projects at one time can stretch a contractor's resources past the point of job quality and profitability. If a contractor does not have access to the appropriate number of experienced project managers, existing managers may be spread too thin or additional managers may be hired who do not have the necessary experience. Additionally, if controls or administrative staffing levels are inadequate, billings may not be accurate or timely, which could negatively affect cash flows and result in subcontractors, suppliers, and employees not being paid in a timely manner or even result in loss of job profit.

.79 In summary, when evaluating management's plans to continue as a going concern, an appropriate level of professional skepticism is important. The company's assumptions about its ability to continue as a going concern should be scrutinized to assess whether they are based on overly optimistic or "once in a lifetime" occurrences.

Cost Shifting

.80 Cost shifting is an accidental or deliberate misstatement in a contractor's job cost system that can have a substantial effect on the contractor's balance sheet and income statement. The most dangerous type of cost shifting involves moving or misdirecting job costs from an unprofitable job to a profitable job. Cost shifting occurs most frequently when field-level managers attempt to manipulate contract profitability.

.81 The effect on the balance sheet from cost shifting is that underbillings (costs and estimated billings in excess of billings) increase and overbillings (billings in excess of costs and estimated earnings) decrease. However, if a loss contract is involved, the accrued liability for loss will be affected, which in turn will affect deferred taxes if an entity is a C-corporation. Underbillings should be rare, especially on contracts that are over 50 percent complete. You should look at underbillings skeptically and investigate each underbilling carefully.

.82 Certain standard audit procedures may not detect cost shifting. Tests designed to search for unrecorded liabilities or to detect improper cutoff will only provide assurance that all costs have been reported in the proper period. Tests designed to locate improperly booked billings or receivables will detect no exceptions. Audit test work for cost shifting must focus on the accuracy of job costing procedures as well as on the cost classification and coding process.

.83 Intentional cost shifting constitutes fraud. An audit is designed to provide reasonable assurance that the statements are free of material misstatement caused by fraud; therefore, consider the following steps in this regard:

- *Test job costs for accuracy.* An audit of a construction contractor should include tests of contract costs and related cost coding.
- *Compare job costs to bid documents.* Because contractors should estimate contract costs in the same manner in which they record job costs, you should test job costs for significant contracts by comparing each item of job cost to the original cost estimate. In addition, field personnel can shift costs by directing a subcontractor to invoice the wrong contract. Audit tests that compare subcontract costs to original bid documents are designed to detect this type of cost shifting.

- *Test revised profitability estimates to bid documents.* Often, cost shifting is accompanied by an upward revision in contract profitability. Consider testing revised profitability estimates in the same manner in which job costs are compared to bid documents.
- *Perform analytics on job cost components.* Contractors who perform similar types of work should have comparable costs from job to job. For example, a grading contractor with equipment-related costs equal to 40 percent of overall direct costs should have a similar relationship on other jobs.
- *Review allocations of indirect job costs.* Cost shifting is often hidden in the allocation of indirect costs, such as internally owned equipment costs, shop costs, insurance, and labor burden. Perform periodic tests to ensure that indirect costs are allocated properly to each job.
- *Perform a fade analysis.* Consider preparing two fade schedules. One schedule compares each job's prior period profitability estimate to the current estimate or actual results. The second schedule restates prior period uncompleted contract schedules using revised profitability figures. Each of these schedules will help you determine which contracts have had unusual fluctuations in profit.
- *Examine bid spreads.* You should compare your client's bid to the second place bidder and to the average bid of all of the bidders. If a contractor is more than 5 percent to 10 percent below other bidders, the contractor may realize little or no profit. Such a job is a prime candidate for cost shifting.
- *Compare profitability estimates to historical results.* A contactor may attempt to hide cost shifting by increasing profit estimates on uncompleted jobs. When this occurs, the gross profit percentages on uncompleted jobs will often exceed the contractor's historical results. You should also consider comparing uncompleted contract gross profit percentages to completed contract percentages.

Accounting Issues and Developments

Revenue Recognition

.84 As noted previously in this alert, SOP 81-1 provides guidance on revenue recognition for construction contractors. SOP 81-1 requires a contractor to use the percentage-of-completion method for recognizing revenue whenever it can produce reasonably dependable estimates. There is a rebuttable presumption that the percentage-of-completion method will produce reasonably dependable estimates.

.85 The completed-contract method should be used only in instances in which reasonable, dependable estimates of construction costs cannot be made. The completed-contract method may also be used if there are no material differences between that method and the percentage-of-completion method. Situations in which there are no material differences may occur when a contractor performs primarily short-term contracts, for example, a small plumbing contractor whose projects are completed in such a short time span that the work is somewhat analogous to the manufacture of shelf production items for sale.

.86 The revenue recognition method should be disclosed in the financial statements. If the percentage-of-completion method is used, the financial statements should disclose the method of computing percentage-of-completion (for example, cost-to-cost). If the completed contract method is used, the reason for selecting the method should be indicated.

.87 In December 1999, the Securities and Exchange Commission (SEC), in an attempt to fill the gap in general revenue recognition guidance, released Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements.* SAB No. 101 was superseded by SAB No. 104, *Revenue Recognition*, in December 2003. Financial statement preparers and auditors of public construction companies are most directly affected by SAB No. 104. However, auditors of nonpublic companies may also find the information contained in SAB No. 104 useful. The issuance of SAB No. 104 did not affect the guidance for revenue recognition contained in SOP 81-1.

Recent Auditing and Attestation Pronouncements and Related Guidance

.88 Presented in the following table is a list of recently issued auditing and attestation pronouncements and related guidance. For information on auditing and attestation standards issued subsequent to the writing of this alert, please refer to the AICPA Web site at www.aicpa.org/Professional+Resources/Accounting+and+Auditing. You may also look for announcements of newly issued standards in the *CPA Letter*, *Journal of Accountancy*, and in the quarterly electronic newsletter, *In Our Opinion*, issued by the AICPA Auditing Standards team, available at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Opinion. As a reminder, AICPA auditing and attestation standards are applicable only to audits and attestation engagements of nonissuers.

.89 The Public Company Accounting Oversight Board (PCAOB) establishes auditing and attestation standards for audits of issuers. Refer to the PCAOB Web site at www.pcaob.org for information about its activities. You may also review AICPA Audit Risk Alert *SEC and PCAOB Alert—2007/08* (product no. 022498kk), which summarizes recent developments at both the SEC and PCAOB. This alert can be obtained by calling the AICPA at (888) 777-7077 or by going online to www.cpa2biz.com.

Recent Auditing and Attestation Pronouncements and Related Guidance	
SAS No. 114, *The Auditor's Communication With Those Charged With Governance* (AICPA, *Professional Standards*, vol. 1, AU sec. 380) Issue Date: December 2006 (Applicable to audits conducted in accordance with generally accepted auditing standards [GAAS])	This standard replaces SAS No. 61, *Communication With Audit Committees* (AICPA, *Professional Standards*, vol. 1, AU sec. 380A). The standard requires the auditor to conduct two-way communication with those charged with governance about certain significant matters related to the audit and also establishes standards and provides guidance on which matters should be communicated, who they should be communicated to, and the form and timing of the communication. It is effective for periods beginning on or after December 15, 2006.

Recent Auditing and Attestation Pronouncements and Related Guidance	
SAS No. 113, *Omnibus Statement on Auditing Standards—2006* (AICPA, *Professional Standards*, vol. 1) Issue Date: November 2006 (Applicable to audits conducted in accordance with GAAS)	This standard does the following: • Revises the terminology used in the 10 standards of SAS No. 95, *Generally Accepted Auditing Standards* (AICPA, *Professional Standards*, vol. 1, AU sec. 150A), to reflect terminology in SAS No. 102, *Defining Professional Requirements in Statements on Auditing Standards* (AICPA, *Professional Standards*, vol. 1, AU sec. 120); • Adds a footnote to the headings before paragraphs 35 and 46 in SAS No. 99, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 316), to provide a clear link between the auditor's consideration of fraud and the auditor's assessment of risk and the auditor's procedures in response to those assessed risks; • Replaces throughout the SASs the term *completion of fieldwork* with the term *date of the auditor's report* • Changes the convention for dating the representation letter by requiring that it be dated as of the date of the auditor's report.
SAS Nos. 104–111, the risk assessment standards Issue Date: March 2006 (Applicable to audits conducted in accordance with GAAS)	See "AICPA Risk Assessment Standards" in this alert.
SAS No. 112, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325) Issue date: May 2006 (Applicable to audits conducted in accordance with GAAS)	This standard supersedes SAS No. 60, *Communication of Internal Control Related Matters Noted in an Audit*. It establishes requirements and provides extensive guidance about communicating matters related to an entity's internal control over financial reporting identified while performing an audit of financial statements. SAS No. 112 also requires that certain communications be in writing. It is effective for periods ending on or after December 15, 2006.

(*continued*)

Recent Auditing and Attestation Pronouncements and Related Guidance	
SAS No. 103, *Audit Documentation* (AICPA, *Professional Standards*, vol. 1, AU sec. 339) Issue date: December 2005	SAS No. 103 supersedes SAS No. 96, *Audit Documentation* (AICPA, *Professional Standards*, vol. 1, AU sec. 339) and amends AU section 530, *Dating of the Independent Auditor's Report* (AICPA, *Professional Standards*, vol. 1). Effective for audits of financial statements for periods ending on or after December 15, 2006, with earlier application permitted, this SAS establishes standards and provides guidance to an auditor of a nonissuer on audit documentation.
Statement on Standards for Attestation Engagements (SSAE) No. 14, *SSAE Hierarchy* (AICPA, *Professional Standards*, vol. 1, AT sec. 50) Issue Date: November 2006	This SSAE identifies the body of attestation literature, clarifies the authority of attestation publications issued by the AICPA and others, specifies the extent of familiarity a practitioner needs to have with various kinds of attestation publications when conducting an attestation engagement, and amends the 11 attestation standards to reflect the terminology used in SSAE No. 13, *Defining Professional Requirements in Statements on Standards for Attestation Engagements* (AICPA, *Professional Standards*, vol. 1, AT sec. 20). It is effective for periods ending on or after December 15, 2006.
Interpretation No. 1, "Communicating Deficiencies in Internal Control Over Compliance in an Office of Management and Budget (OMB) Circular A-133 Audit" (AICPA, *Professional Standards*, vol. 1, AU sec. 9325.01–.04), which interprets AU section 325, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1) Issue Date: July 2007 (Interpretive publication)	This auditing interpretation interprets AU section 325, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1), and addresses how the definitions of the terms *control deficiency*, *significant deficiency*, and *material weakness* should be adapted and applied in the context of reporting on internal control over compliance in a single audit.

Recent Auditing and Attestation Pronouncements and Related Guidance	
Interpretation No. 1, "Use of Electronic Confirmations" (AICPA, *Professional Standards,* vol. 1, AU sec. 9330.01–.06), which interprets AU section 330, *The Confirmation Process* (AICPA, *Professional Standards*, vol. 1) Issue Date: March 2007 (Interpretive publication)	This auditing interpretation interprets AU section 330, *The Confirmation Process* (AICPA, *Professional Standards*, vol. 1), and addresses the issue of electronic confirmations.
AICPA Technical Practice Aid (TPA) Technical Questions and Answers (TIS) section 9100.06, "The Effect of Obtaining the Management Representation Letter on Dating the Auditor's Report" (AICPA, *Technical Practice Aids*) Issue Date: May 2007 (Nonauthoritative)	This question and answer discusses whether the auditor is required to have the signed management representation letter in hand as of the date of the auditor's report. The question and answer indicates that although the auditor need not be in physical receipt of the representation letter on the date of the auditor's report, management will need to have reviewed the final representation letter and, at a minimum, have orally confirmed that they will sign the representation letter, without exception, on or before the date of the representations.
AICPA TPA TIS section 8350.01, "Current Year Audit Documentation Contained in the Permanent File" (AICPA, *Technical Practice Aids*) Issue Date: May 2007 (Nonauthoritative)	This question and answer discusses whether the provisions of SAS No. 103, *Audit Documentation* (AICPA, *Professional Standards*, vol. 1, AU sec. 339), related to documentation completion and retention, apply to current year audit documentation maintained in the permanent file. The question and answer indicates that SAS No. 103 does apply to current year audit documentation maintained in a permanent file, or, for that matter, maintained in any type of file, if the documentation serves as support for the current year's audit report.
AICPA Professional Issues Task Force (PITF) Practice Alert (PA) 03-1, *Audit Confirmations* (AICPA, *Technical Practice Aids*, PA sec. 16,240) Revised: June 2007 (Nonauthoritative)	This practice alert responds to practitioners' current concerns about audit confirmations and includes discussion of improving confirmation response rates, negative versus positive confirmation requests, nonresponses to positive confirmations, responses to positive confirmation requests indicating exception, and use of electronic confirmations among other topics.

(*continued*)

Recent Auditing and Attestation Pronouncements and Related Guidance	
AICPA PITF PA 07-1, *Dating of the Auditor's Report and Related Practical Guidance* (AICPA, *Technical Practice Aids*, PA sec. 16,290) Issue Date: January 2007 (Nonauthoritative)	This practice alert provides guidance regarding application of certain provisions of SAS No. 103, primarily related to dating the auditor's report.

The Auditor's Communication With Those Charged With Governance

.90 In December 2006, the Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 114, *The Auditor's Communication With Those Charged With Governance* (AICPA, *Professional Standards*, vol. 1, AU sec. 380), which supersedes SAS No. 61, *Communication With Audit Committees* (AICPA, *Professional Standards*, vol. 1, AU sec. 380A). The new SAS establishes standards and provides guidance to auditors on matters required to be communicated with those charged with governance in relation to an audit of financial statements and is effective for audits of financial statements for periods beginning on or after December 15, 2006. SAS No. 61 established communication requirements applicable to entities that either have an audit committee or that have otherwise formally designated oversight of the financial reporting process to a group equivalent to an audit committee. However, SAS No. 114 broadens the applicability of the SAS to audits of the financial statements of all nonissuers regardless of size, ownership, or organizational structure.

.91 SAS No. 114 recognizes the importance to the audit of effective two-way communication. It provides a framework for the auditor's communication with those charged with governance and identifies specific matters to be communicated, many of which are generally consistent with the requirements in SAS No. 61. However, SAS No. 114 does include certain additional matters to be communicated and provides additional guidance on the communication process. Among other matters, SAS No. 114 adds requirements to communicate an overview of the planned scope and timing of the audit. It also requires significant matters communicated with those charged with governance to be documented.

Identifying Those Charged With Governance

.92 The SAS uses the term *those charged with governance* to refer to those with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity, including overseeing the entity's financial reporting process. The SAS uses the term *management* to refer to those who are responsible for achieving the objectives of the enterprise and who have the authority to establish policies and make decisions by which those objectives are to be pursued.

.93 The auditor should determine the appropriate person(s) within the entity's governance structure with whom to communicate. The appropriate person(s) may vary depending on the matter to be communicated. Governance structures vary by entity, reflecting influences such as size and ownership characteristics.

.94 Since there is such diversity, it is not possible for SAS No. 114 to specify for all audits the person(s) with whom the auditor is to communicate particular matters. Furthermore, in some cases the appropriate person(s) with whom to communicate may not be clearly identifiable from the engagement circumstances, for example, entities where the governance structure is not formally defined, such as some family-owned entities, some not-for-profit organizations, and some government entities. The auditor's understanding of the entity's governance structure and processes obtained in accordance with SAS No. 109, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*, vol. 1, AU sec. 314), is relevant in deciding with whom to communicate matters. When the appropriate person(s) with whom to communicate are not clearly identifiable, the auditor and the engaging party should agree on the relevant person(s) within the entity's governance structure with whom the auditor will communicate.

Communicating Internal Control Related Matters Identified in an Audit

.95 In May 2006, the AICPA ASB issued SAS No. 112, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325). SAS No. 112 establishes standards and provides guidance on communicating matters related to an entity's internal control over financial reporting (internal control) identified in an audit of financial statements. SAS No. 112 supersedes SAS No. 60, *Communication of Internal Control Related Matters Noted in an Audit*, as amended. The new SAS is applicable whenever an auditor expresses an opinion on financial statements (including a disclaimer of opinion) and is effective for audits of financial statements for periods ending on or after December 15, 2006. Among other things, SAS No. 112 does the following:

- Requires the auditor to communicate control deficiencies that are *significant deficiencies* or *material weaknesses* in internal control. The terms are defined in the SAS. The term *reportable condition* is no longer used. When SAS No. 112 was issued, the terms *significant deficiencies* and *material weaknesses* were consistent with PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements* (AICPA, *PCAOB Standards and Related Rules*, AU sec. 320). However, with the adoption of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* (AICPA, *PCAOB Standards and Related Rules*, Rules of the Board, "Standards"), the PCAOB redefined these terms, which now differ from SAS No. 112.
- Provides guidance on evaluating the severity of control deficiencies identified in an audit of financial statements and requires that the auditor conclude whether prudent officials, having knowledge of the same facts and circumstances, would agree with the auditor's classification of the deficiency.
- Identifies areas in which control deficiencies ordinarily are to be evaluated as at least significant deficiencies and identifies

indicators that control deficiencies should be regarded as at least a significant deficiency and a strong indicator of a material weakness.

- Requires the auditor to communicate significant deficiencies and material weaknesses identified in the audit, in writing, to management and those charged with governance. This includes the significant deficiencies and material weaknesses that were communicated in previous audits if they have not yet been remediated.
- Indicates that the communication must be in writing and is best made by the report release date (the date on which the auditor grants permission for the client to use the auditor's report in connection with the financial statements), but should be made no later than 60 days following the *report release date.*
- Contains illustrative written communications to management and those charged with governance.

How Revisions of SAS No. 112 Affect Practice

.96 As auditors gain a better understanding of what needs to be communicated to management and those charged with governance, there may be more control deficiencies that are identified as significant deficiencies and material weaknesses and that are then communicated to management and those charged with governance. Auditors may emphasize and therefore spend more time evaluating identified control deficiencies than in the past.

Discussions With Management and Others

.97 The new requirements of SAS No. 112 may change perceptions regarding the auditor's role in the client's internal control. Auditors may have to explain to clients that the auditor *cannot* be a part of their internal control. Only the client—not the auditor—can correct control deficiencies. However, a CPA firm other than the auditor who does not provide attest services for the client can be part of a client's internal control. This may raise new questions regarding the role of outsourcing in achieving management's internal control objectives.

.98 Auditors may be called upon to hold discussions with management and other users of the auditor's written communication, such as regulators, to explain why the nature and extent of the internal control matters communicated to management and those charged with governance are different from the matters communicated in prior years. One reason is that the criteria have changed because of the introduction of the term *significant deficiencies* and its definition as well as a new definition of material weaknesses. Another reason is that auditors have to include significant deficiencies and material weaknesses, identified and communicated in previous years, in written communication as long as these deficiencies have not been remediated. Auditors may need to explain to management and other users that the auditors are required to inform them of the significant deficiencies and material weaknesses every year as long as those deficiencies still exist.

.99 Auditors may also need to hold discussions with management and other users who ask how the auditors were able to express an unqualified opinion on the financial statements when material weaknesses in internal control were present. Auditors may wish to explain that the audit was designed to provide reasonable assurance that the financial statements are free from material misstatements. Internal control should be designed to prevent or detect material misstatements. As previously stated, the auditor cannot be part of a client's internal control system. Auditors can express an unqualified opinion on the financial statements even though material weaknesses in internal control are present because sufficient procedures were performed and appropriate audit evidence was obtained to afford reasonable assurance that the financial statements are free from material misstatement. However, these procedures do not *correct or remediate* control deficiencies; the deficiencies in internal control could still result in a material misstatement not being prevented, detected, and corrected by the client.

Issues for Audits of Smaller Entities

.100 One issue that has arisen in audits of smaller entities is the increase in costs as a result of the time the auditor spends documenting his or her evaluation of internal control and evaluating identified control deficiencies.

.101 Another issue that has caused concern is the extent to which the auditor may be involved in the drafting of an entity's financial statements. It is a strong indication of material weakness in internal control if a client has ineffective controls over the preparation of its financial statements such that client controls are absent or controls are not effective in preventing, detecting, or correcting material misstatements in the preparation of financial statements, including the related notes. Although the auditor can propose adjustments and assist in assembling or drafting the financial statements, the auditor cannot establish or maintain the client's controls, including monitoring ongoing activities, because doing so would impair independence.[1] How an auditor responds to a client's internal control weakness, in terms of designing and carrying out auditing procedures, does not affect or mitigate a client's internal control weakness. Just as an auditor's response to detection risk is independent of the client's control risk, so too the auditor's response to a client's control weakness by assisting in drafting the financial statements does not change that control weakness.

.102 The requirements of SAS No. 112 introduce possible opportunities for auditors. Auditors can help clients evaluate the cost-benefit implications of improving their internal control, including training their personnel to be more knowledgeable. Auditors can also teach clients how to develop a risk assessment approach to designing internal control. Readers should also note that the Internal Control Task Force of the ASB is revising SAS No. 112 in response to the adoption of PCAOB Auditing Standard No. 5 and International Standards on Auditing.

.103 The AICPA has published the AICPA Audit Risk Alert titled *Understanding SAS No. 112 and Evaluating Control Deficiencies* (product no. 022536kk) to assist in implementation of this SAS. This Audit Risk Alert provides specific case studies to help determine whether identified control weaknesses would constitute a significant deficiency or material weakness; it can be obtained by calling the AICPA at (888) 777-7077 or going online at www.cpa2biz.com.

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[1] See Ethics Ruling 101-3, "Performance of nonattest services," of the AICPA Code of Professional Conduct (AICPA, *Professional Standards*, vol. 2, ET sec. 101.05).

AICPA Risk Assessment Standards

.104 In March 2006, the AICPA ASB issued eight SASs referred to as the risk assessment standards (SAS Nos. 104–111). Although the SASs include many of the underlying concepts and detailed performance requirements contained in existing standards, they do create significant new requirements for the auditor. The risk assessment standards provide extensive guidance on how to apply the audit risk model when planning and performing financial statement audits, focusing on identifying and assessing the risks of material misstatements, further designing and performing tailored audit procedures in response to the assessed risks at relevant assertion levels, and improving the linkage between the risks, controls, audit procedures, and conclusions. The risk assessment standards are effective for audits of financial statements for periods beginning on or after December 15, 2006, with earlier applications permitted. The following table lists the eight SASs and their effects on existing standards.

Statement on Auditing Standards	***Effect on Existing Standards***
SAS No. 104, *Amendment to Statement on Auditing Standards No. 1,* Codification of Auditing Standards and Procedures *("Due Professional Care in the Performance of Work")* (AICPA, *Professional Standards*, vol. 1, AU sec. 230)	This statement amends SAS No. 1, *Due Professional Care in the Performance of Work* (AICPA, *Professional Standards*, vol. 1, AU sec. 230A).
SAS No. 105, *Amendment to Statement on Auditing Standards No. 95,* Generally Accepted Auditing Standards (AICPA, *Professional Standards*, vol. 1, AU sec. 150)	This statement amends SAS No. 95, *Generally Accepted Auditing Standards* (AICPA, *Professional Standards*, vol. 1, AU sec. 150A).
SAS No. 106, *Audit Evidence* (AICPA, *Professional Standards*, vol. 1, AU sec. 326)	This statement supersedes SAS No. 31, *Evidential Matter* (AICPA, *Professional Standards*, vol. 1, AU sec. 326A).
SAS No. 107, *Audit Risk and Materiality in Conducting an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 312)	This statement supersedes SAS No. 47, *Audit Risk and Materiality in Conducting an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 312A).
SAS No. 108, *Planning and Supervision* (AICPA, *Professional Standards*, vol. 1, AU sec. 311)	This statement supersedes SAS No. 1, *Appointment of the Independent Auditor* (AICPA, *Professional Standards*, AU sec. 310), and supersedes SAS No. 22, *Planning and Supervision* (AICPA, *Professional Standards*, vol. 1, AU sec. 311A).

Statement on Auditing Standards	*Effect on Existing Standards*
SAS No. 109, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*, vol. 1, AU sec. 314)	This statement supersedes SAS No. 55, *Consideration of Internal Control in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 319).
SAS No. 110, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (AICPA, *Professional Standards*, vol. 1, AU sec. 318)	This statement supersedes SAS No. 45, *Substantive Tests Prior to the Balance Sheet Date* (AICPA, *Professional Standards*, vol. 1, AU sec. 313), and together with SAS No. 109, supersedes SAS No. 55, *Consideration of Internal Control in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 319).
SAS No. 111, *Amendment to Statement on Auditing Standards No. 39,* Audit Sampling (AICPA, *Professional Standards*, vol. 1, AU sec. 350)	This statement amends SAS No. 39, *Audit Sampling* (AICPA, *Professional Standards*, vol. 1, AU sec. 350A).

Key Provisions of the Risk Assessment Standards

.105 Whether due to error or fraud, the new risk assessment standards require the auditor to understand and respond to the risks of material misstatement. That understanding should identify risks that may lead to a material misstatement in the client's financial statements and any mitigating controls in place. The risk assessment standards place an even greater emphasis on the understanding and testing of internal control. Auditors may no longer simply default to a maximum control risk. Although this does not mean auditors are required to test and rely on controls as part of their audit strategy, they should assess how all five components of internal control over financial reporting relate to the client that they are auditing (see the Committee on Sponsoring Organizations of the Treadway Commission's framework, www.coso.org/key.htm). These standards may significantly affect the formality of your risk assessment and documentation and may vary greatly from what auditors have previously done. Implementation of the SASs will most likely result in significant changes to firm audit methodologies and the training of personnel. Therefore, it is recommended that auditors allow ample time in advance of the required implementation date. Readers can obtain the SASs and the related AICPA Audit Risk Alert titled *Understanding the New Auditing Standards Related to Risk Assessment* (product no. 022526kk) by calling the AICPA at (888) 777-7077 or going online at www.cpa2biz.com.

Companion Audit Guide

.106 In December 2006, the AICPA published the Audit Guide *Assessing and Responding to Audit Risk in a Financial Statement Audit* (product no.

012456kk). This guide helps auditors understand and implement the risk assessment standards. It includes practical guidance, examples, and an in-depth case study. The guide can be ordered by calling the AICPA at (888) 777-7077 or going online at www.cpa2biz.com.

Audit Documentation Technical Practice Aids

.107 In May 2007, the ASB issued two Technical Practice Aid (TPA) Technical Questions and Answers (TIS) related to SAS No. 103, *Audit Documentation* (AICPA, *Professional Standards*, vol. 1, AU sec. 339), which was issued in December 2005.

.108 TIS section 9100.06, "The Effect of Obtaining the Management Representation Letter on Dating the Auditor's Report" (AICPA, *Technical Practice Aids*), discusses whether the auditor is required to have the signed management representation letter in hand as of the date of the auditor's report. This question and answer indicates that although the auditor need not be in physical receipt of the representation letter on the date of the auditor's report, management will need to have reviewed the final representation letter and, at a minimum, have orally confirmed that they will sign the representation letter, without exception, on or before the date of the representations. The auditor will need to have the signed management representation letter in hand prior to releasing the auditor's report because management's refusal to furnish written representations constitutes a limitation on the scope of the audit sufficient to preclude an unqualified opinion.

.109 TIS section 8350.01, "Current Year Audit Documentation Contained in the Permanent File" (AICPA, *Technical Practice Aids*), discusses whether the provisions of SAS No. 103 related to documentation completion and retention apply to current year audit documentation maintained in the permanent file. This question and answer indicates that SAS No. 103 does apply to current year audit documentation maintained in a permanent file, or for that matter, maintained in any type of file, if the documentation serves as support for the current year's audit report.

Practice Alert No. 07-1, *Dating of the Auditor's Report and Related Practical Guidance*

.110 A key provision of SAS No. 103 is the amendment to paragraphs .01 and .05 of AU section 530, *Dating of the Independent Auditor's Report* (AICPA, *Professional Standards*, vol. 1), to require that the auditor's report not be dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence to support the opinion on the financial statements. As defined in the footnote to paragraph .01 of AU section 530, sufficient appropriate audit evidence includes, among other things, evidence that the audit documentation has been reviewed and that the entity's financial statements, including disclosures, have been prepared and that management has asserted that they have taken responsibility for them. Application of the rules may require revising the process used by audit firms at the end of fieldwork to include a field review of the audit working papers and financial statements. For some firms an additional visit to the client's office to update subsequent event analysis and management's representations may be required as well.

.111 The Professional Issues Task Force (PITF) issued this practice alert to provide guidance to auditors of nonissuers regarding the following:

- The audit report date
- Evidence supporting financial statement amounts and disclosures, specifically relating to attorney letters, obtaining waivers, and consideration and evaluation of subsequent events
- Financial statement preparation and management's assertions
- Evidence that the audit documentation has been reviewed

.112 Readers may access the practice alert at www.aicpa.org/download/auditstd/pract_alert/pa_2007_1.pdf. Readers should also note the PITF is currently working on a practice alert that addresses auditing and other considerations related to electronic information that it plans to issue during the third quarter of 2007.

PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of Financial Statements*

.113 In May 2007, the PCAOB adopted Auditing Standard No. 5, which was later approved by the SEC on July 25, 2007. This standard replaces Auditing Standard No. 2. Auditing Standard No. 5 is principles-based and presents a risk-based, top-down approach designed to increase the likelihood that material weaknesses will be found before resulting in a material misstatement of a company's financial statements, while eliminating unnecessary procedures. The standard was also designed to make audits more scalable for smaller or less complex companies. The PCAOB worked closely with the SEC to coordinate Auditing Standard No. 5 with the guidance to public company management that was approved by the SEC in May 2007. Mark Olson, PCAOB Chairman, stated "The new standard is more risk-based and scalable, which will better meet the needs of investors, public companies, and auditors alike."

.114 This new standard is required for all audits of internal control for fiscal years ending on or after November 15, 2007. However, early adoption is permitted and encouraged. For more information, readers may refer to the *SEC and PCAOB Alert—2007/08* (product no. 022498kk).

Recent AICPA Independence and Ethics Pronouncements

.115 The AICPA *Independence and Ethics Alert—2007/08* (product no. 022478kk) contains a complete update on new independence and ethics pronouncements. This alert can be obtained by calling the AICPA at (888) 777-7077 or going online at www.cpa2biz.com. Readers should obtain this alert to be aware of independence and ethics matters that will affect their practice.

Recent Accounting Pronouncements and Related Guidance

.116 Presented in the following table is a list of recently issued accounting pronouncements and related guidance. For information on accounting standards issued subsequent to the writing of this alert, please refer to the AICPA Web site at www.aicpa.org and the FASB Web site at www.fasb.org. You may also look for announcements of newly issued standards in the *CPA Letter* and *Journal of Accountancy*.

Recent Accounting Pronouncements and Related Guidance	
FASB Statement No. 159 (February 2007)	*The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115*
FASB Statement No. 158 (September 2006)	*Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)*
FASB Statement No. 157 (September 2006)	*Fair Value Measurements*
FASB Interpretation No. 48 (June 2006)	*Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*
FASB Emerging Issues Task Force (EITF) Issues (Various dates)	Go to www.fasb.org/eitf/agenda.shtml for a complete list of EITF Issues.
FASB Staff Positions (FSPs) (Various dates)	Go to www.fasb.org/fasb_staff_positions/ for a complete list of FSPs.
AICPA Statement of Position (SOP) 07-1 (AICPA, *Technical Practice Aids*, ACC sec. 10,930)	*Clarification of the Scope of the Audit and Accounting Guide* Investment Companies *and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies*
TIS section 6140.20–.22 (AICPA, *Technical Practice Aids*) (Nonauthoritative)	These questions and answers discuss not-for-profit organizations fund-raising expenses.
TIS section 6931.08–.10 (AICPA, *Technical Practice Aids*) (Nonauthoritative)	These questions and answers discuss various employee benefit plan topics.
TIS section 6300.25–.35 (AICPA, *Technical Practice Aids*) (Nonauthoritative)	These questions and answers discuss various issues related to SOP 05-1, *Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection With Modifications or Exchanges of Insurance Contracts*.
AICPA Practice Guide (Nonauthoritative)	"Practice Guide on Accounting for Uncertain Tax Positions Under FIN 48"

.117 Of the accounting pronouncements and related guidance listed in the previous table, those having particular significance to the construction industry are briefly explained here. The following summaries are for informational purposes only and should not be relied upon as a substitute for a complete reading of the applicable standard. The AICPA general *Audit Risk Alert—2007/08* and other AICPA industry-specific alerts also contain summaries of recent pronouncements that may not be discussed here. To obtain copies of AICPA literature, call (888) 777-7077 or go online at www.cpa2biz.com.

Fair Value Measurements

FASB Statement No. 157

.118 In September 2006, the FASB issued FASB Statement No. 157, *Fair Value Measurements*, to provide enhanced guidance for using fair value to measure assets and liabilities. This standard defines fair value and expands disclosures about fair value measurements. The standard applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances.

.119 Prior to this statement, there were different definitions of fair value, and guidance for applying those definitions was dispersed among many accounting pronouncements. Difference in the existing guidance created inconsistencies that added to the complexity in applying generally accepted accounting principles (GAAP). FASB Statement No. 157 provides increased consistency and comparability in fair value measurements. Expanded disclosures about the use of fair value to measure assets and liabilities should provide users of financial statements with better information about the use of fair value in the financial statements, the inputs used to develop the measurements, and the effect of the measurements on earnings (or changes in net assets) for the period. The statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Early adoption is permitted. Readers can access the full text of FASB Statement No. 157 on the FASB Web site at www.fasb.org.

FASB Statement No. 159

.120 Subsequent to the issuance of FASB Statement No. 157, the FASB issued FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115*. This statement is expected to expand the use of fair value measurement, which is consistent with the FASB's long-term measurement objectives for accounting for financial instruments. FASB Statement No. 159 allows entities to choose to measure many financial instruments and certain other items at fair value. The standard permits an entity to elect the fair value option on an instrument-by-instrument basis; and once the election is made, it is irrevocable. This statement's objective is to improve financial reporting by providing entities with an opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. In addition, FASB Statement No. 159 establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. The statement does not eliminate disclosure requirements included in other accounting standards, such as the requirements for disclosures about fair value measurements included in FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, and FASB Statement No. 157.

.121 FASB Statement No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007, provided the entity also elects to apply the provisions of FASB Statement No. 157. The choice to adopt early should be made within 120 days of the beginning of the fiscal year of adoption (for calendar year end entities, by April 2007), provided the entity has not yet issued financial statements, including required notes to those financial statements, for any interim period of the fiscal year of adoption. The FASB and SEC have expressed concern in the way some early adopters have applied the transition provisions of the standard. The AICPA Center for Audit Quality (CAQ) issued an alert on this development in April 2007. The alert advises auditors to exercise appropriate professional skepticism when evaluating if a principles-based standard such as this is applied in a good faith manner consistent with those objectives and principles. Specifically the alert warns auditors to "be alert for circumstances in which an entity proposes to adopt FAS 159 in a manner that is contrary to the principles and objectives outlined in the standard." The alert can be accessed at www.thecaq.org/newsroom/pdfs/CAQPressRelease_041807a.pdf. Readers can access the full text of FASB Statement No. 159 on the FASB Web site at www.fasb.org.

On the Horizon

.122 Auditors should keep abreast of auditing and accounting developments and upcoming guidance that may affect their engagements. Presented in the following sections is brief information about some ongoing projects that have particular significance to the construction industry or that may result in significant changes. Remember that exposure drafts are nonauthoritative and cannot be used as a basis for changing existing standards.

.123 The following table lists the various standard-setting bodies' Web sites, where information may be obtained on outstanding exposure drafts, including downloading exposure drafts. These Web sites contain much more in-depth information about proposed standards and other projects in the pipeline. Many more accounting and auditing projects exist in addition to those discussed here. Readers should refer to information provided by the various standard-setting bodies for further information.

Standard-Setting Body	***Web Site***
AICPA Auditing Standards Board (ASB)	www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Auditing+Standards+Board/
AICPA Accounting Standards Executive Committee (AcSEC)	www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+Standards/
Financial Accounting Standards Board (FASB)	www.fasb.org
Public Company Accounting Oversight Board (PCAOB)	www.pcaob.org

Standard-Setting Body	*Web Site*
Professional Ethics Executive Committee (PEEC)	www.aicpa.org/Professional+Resources/ Professional+Ethics+Code+of+Professional+Conduct/ Professional+Ethics/
Securities and Exchange Commission (SEC)	www.sec.gov

Help Desk—The AICPA's standard-setting committees publish exposure drafts of proposed professional standards exclusively on the AICPA Web site. The AICPA will notify interested parties by e-mail about new exposure drafts. To be added to the notification list for all AICPA exposure drafts, send your e-mail address to service@aicpa.org. Indicate "exposure draft e-mail list" in the subject header field to help process your submission more efficiently. Include your full name, mailing address, and, if known, your membership and subscriber number in the message. The AICPA Web site also has connecting links to the other standard-setting bodies listed here.

Auditing Pipeline—Nonissuers

ASB Clarity Project

.124 The ASB has formed a Clarity Task Force to address concerns over the clarity, length, and complexity of generally accepted auditing standards. In March 2007, the ASB approved for exposure a discussion paper titled *Improving the Clarity of ASB Standards*. This discussion paper seeks feedback on proposed changes to the standards, including:

- Establishing objectives for each of the standards, and the auditor's obligations related to the objectives
- Structural and drafting improvements to make the standards easier to read and understand
- Inclusion, in the explanatory material of the standards, of special considerations related to audits of public entities and small entities
- Establishing a glossary of terms that would be presented in a separate section of the codification of the standards

.125 The period to comment ended June 15, 2007. The discussion paper can be accessed at www.aicpa.org/download/auditstd/Clarity_of_ASB_Standards_Discussion_Memo.pdf.

Convergence With International Standards

.126 The ASB has created a number of task forces charged with monitoring specific activities of the International Auditing and Assurance Standards Board (IAASB) and working toward convergence with international auditing standards. The ASB has commented on several exposure drafts of International Standards on Auditing (ISA). The status of these and other ASB projects can be monitored online at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Auditing+Standards+Board/.

Proposed Statement on Standards for Attestation Engagements Regarding Reporting on an Entity's Internal Control Over Financial Reporting

.127 In January 2006, the ASB issued a revised exposure draft of a proposed Statement on Standards for Attestation Engagements (SSAE) that would supersede Chapter 5, "Reporting on an Entity's Internal Control Over Financial Reporting," of SSAE No. 10, *Attestation Engagements: Revision and Recodification* (AICPA, *Professional Standards*, vol. 1, AT sec. 501), as amended. This proposed SSAE establishes standards and provides guidance to the practitioner who is engaged to issue or does issue an examination report on the effectiveness of an entity's internal control over financial reporting as of a point in time (or on an assertion thereon). As mentioned previously, in May 2007, the PCAOB adopted Auditing Standard No. 5, which replaces Auditing Standard No. 2. Knowing the forthcoming changes would be relevant to the revision of AT section 501, the ASB previously decided to defer to issuance of a final revised AT section 501 until the PCAOB issued its amendments and the ASB had time to consider them. The Internal Control Task Force of the ASB is responsible for this revision. Readers may monitor progress on the AICPA Web site at www.aicpa.org.

Proposed Amendment to SAS No. 69, The Meaning of *Present Fairly in Conformity With Generally Accepted Accounting Principles*

.128 In May 2005, the ASB issued an exposure draft introducing a proposed SAS titled *Amendment to Statement on Auditing Standards No. 69,* The Meaning of *Present Fairly in Conformity With Generally Accepted Accounting Principles, for Nongovernmental Entities*. This proposed SAS, which applies only to nongovernmental entities, has been issued in response to the FASB's proposed Statement of Financial Accounting Standards titled *The Hierarchy of Generally Accepted Accounting Principles*. The FASB proposal moves responsibility for the GAAP hierarchy for nongovernmental entities from the auditing literature (SAS No. 69 [AICPA, *Professional Standards*, vol. 1, AU sec. 411]) to the accounting literature. The proposed SAS deletes the GAAP hierarchy for nongovernmental entities from SAS No. 69. The ASB decided to coordinate the provisions and effective date of this exposure draft with the proposed FASB statement, which can be obtained at www.fasb.org. The ASB will issue its final SAS coincidentally with the FASB's and PCAOB's issuance of their final standards.

Auditing Pipeline—Issuers

.129 Guidance issued by the PCAOB is included in the section of this alert titled "Recent Auditing and Attestation Pronouncements and Related Guidance." For more information regarding recent developments at both the SEC and PCAOB, readers may refer to the *SEC and PCAOB Alert—2007/08* (product no. 022498kk), mentioned previously.

Accounting Pipeline

.130 Presented below are accounting projects and pronouncements currently in process. Some of the proposed pronouncements discussed in the prior year alert have not been finalized as of the date of this writing, and thus are included again.

Business Combinations

.131 Phase one of the business combination project resulted in the issuance of FASB Statement No. 141, *Business Combinations*, and FASB Statement No. 142, *Goodwill and Other Intangible Assets*. In those statements, the FASB eliminated the use of the pooling of interests method of accounting for business combinations and addressed purchase accounting guidelines for acquired intangible assets and goodwill and goodwill impairment. The objective of phase two of this project is to standardize business combination accounting through the convergence of the FASB and International Accounting Standards Board (IASB) accounting standards and by reconsidering the existing guidance for the purchase method of accounting for business combinations. Among the main proposals are the following:

- All acquisitions of businesses be measured at the fair value of the business acquired.
- Substantially all the assets acquired and liabilities assumed of the acquired business be recognized and measured at their fair values at the acquisition date.
- Entities that follow U.S. GAAP and international standards apply substantially the same accounting requirements for their business combinations.

.132 In June 2005, the FASB and IASB issued a number of exposure drafts, for which comment periods ended in October 2005. Redeliberations began in January 2006 and were completed in June 2007. FASB and IASB expect to issue final statements during the fourth quarter of 2007. Four standards are expected to be issued:

- Proposed FASB Statement No. 141(R) and International Financial Reporting Standard (IFRS) No. 3(R), *Business Combinations*
- Proposed FASB Statement No. 160, *Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries*
- Proposed International Accounting Standard (IAS) Statement No. 27(R)

.133 Readers should remain alert to the final issuances and visit the FASB Web site for further information.

Fair Value

.134 During phase one of the FASB's fair value option project, the FASB issued FASB Statement No. 159, which was previously discussed. In phase two of the project, the FASB will consider allowing the fair value option for certain nonfinancial assets and nonfinancial liabilities and deposit liabilities of depository institutions, which are excluded from the scope of FASB Statement No. 159. Deliberations on phase two are expected to begin in the third quarter of 2007. Readers should remain alert to developments by visiting the FASB Web site.

Derivative Disclosures

.135 In December 2006, the FASB issued an exposure draft titled *Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133*. The comment period for this exposure ended in

March 2007, and the FASB has begun redeliberations to consider significant issues raised by respondents. The objective of this project is to provide guidance on enhanced disclosure requirements and balance sheet and income statement display of derivatives accounted for in accordance with FASB Statement No. 133 including how and why an entity uses derivative instruments; how derivative instruments and related hedged items are accounted for under FASB Statement No. 133; and how derivative instruments affect an entity's financial position, results of operations, and cash flows. Readers can monitor the progress of this project on the FASB Web site.

Transfers of Financial Assets

.136 The FASB is working on a project to amend FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125*, to address issues related to the permitted activities of a qualifying special-purpose entity (QSPE), isolation criteria, and other issues that arose during redeliberations on the amendment of FASB Statement No. 140 to improve comparability of financial statements. In August 2005, the FASB issued exposure draft, *Accounting for Transfers of Financial Assets*, which was a revision of a June 2003 exposure draft. During 2007, the FASB expects to address issues related to the permitted activities of a QSPE and then issue another exposure draft during the fourth quarter of 2007 containing potential amendments to FASB Statement No. 140. See the FASB Web site for complete information.

Earnings Per Share

.137 The FASB and IASB have been working together to resolve differences between FASB Statement No. 128, *Earnings per Share*, and IAS Statement No. 33, *Earnings per Share*. This project is part of the larger FASB project, Short-term International Convergence, which has resulted in the issuance of a number of FASB Statements. Currently the FASB and IASB are addressing significant differences that remain relating to instruments that can be settled in cash or shares and are classified as a liability on an entity's balance sheet. The FASB and IASB are considering modifications to the treasury stock method and several scoping issues in which either the FASB and IASB has issued or may issue more detailed implementation guidance on earnings per share that may create a convergence difference. The FASB and IASB are expected to issue an exposure draft for public comment during the third quarter of 2007. This exposure draft will be the third exposure draft the FASB has issued on the earnings per share project. The project and current exposure draft can be reviewed on the FASB Web site.

FASB Codification and Retrieval Project

.138 The goal of this FASB project is to create a single, authoritative codification of U.S. GAAP. The codification will integrate and topically organize all relevant accounting guidance issued by the U.S. standard setters (FASB, AICPA, EITF, and the SEC). The codification will have a three layered structure: topic, subtopic, and section. The FASB has structured the topics into three primary areas: overall presentation, transactional (or financial statement account), and industry. The overall presentation area addresses presentation of financial information but does not address items such as recognition, measurement, or derecognition. The transactional or financial statement account area addresses accounting recognition, measurement, or derecognition.

The industry area includes guidance unique to the industry. A codification draft is expected in 2007 and will have an extended verification period to ensure that it accurately reflects U.S. GAAP. Once the FASB addresses respondent comments, the codification will become the single authoritative source of U.S. GAAP and will supersede all existing standards. Readers can track progress of the Codification and Retrieval Project on the FASB Web site at www.fasb.org/project/codification&retrieval_project.shtml.

GAAP Hierarchy

.139 This proposed statement would identify the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental companies that are presented in conformity with U.S. GAAP (or the GAAP hierarchy). The GAAP hierarchy is currently presented in AICPA SAS No. 69. However, the FASB believes that the GAAP hierarchy should be directed specifically to companies because it is the company, not the auditor, which is responsible for selecting its accounting principles for financial statements. Accordingly, the FASB concluded that the GAAP hierarchy should reside in the accounting literature established by the FASB. The FASB decided to carry forward the GAAP hierarchy as set forth in SAS No. 69, subject to certain modifications. The FASB staff will coordinate with the AICPA (as previously discussed in the "Auditing Pipeline—Nonissuers" section) to ensure that each of the documents has a uniform effective date. Readers should be alert for the issuance of a final statement.

Proposed FASB EITFs and FSPs

.140 ***Proposed FASB EITF Issues.*** Numerous open issues are under deliberation by the EITF. Readers should visit the FASB Web site at www.fasb.org/eitf/agenda.shtml for complete information.

.141 ***Proposed FSPs.*** A number of proposed FSPs are currently in progress. Readers should visit the FASB Web site at www.fasb.org/fasb_staff_positions/ for complete information.

Resource Central

.142 The following are various resources that practitioners engaged in the construction industry may find beneficial.

Publications

.143 Practitioners may find the following publications useful with respect to the construction industry:

- Audit and Accounting Guide *Construction Contractors* (2007) (product no. 012587kk)
- Audit Guide *Analytical Procedures* (2007) (product no. 012557kk)
- Audit Guide *Assessing and Responding to Audit Risk in a Financial Statement Audit* (2006) (product no. 012456kk)
- Audit Guide *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* (2007) (product no. 012527kk)
- Audit Guide *Auditing Revenue in Certain Industries* (2007) (product no. 012517kk)

- Audit Guide *Audit Sampling* (2007) (product no. 012537kk)
- Audit Guide *Service Organizations: Applying SAS No. 70, as Amended* (2007) (product no. 012777kk)
- AICPA *Audit Risk Alert—2007/08* (product no. 022338kk)
- *Compilation and Review AICPA/Alert—2007/08* (product no. 022308kk)
- *Independence and Ethics AICPA/Alert—2007/08* (product no. 022478kk)
- Audit Risk Alert *SEC and PCAOB Alert—2007/08* (product no. 022498kk)
- Audit Risk Alert *Understanding the New Auditing Standards Related to Risk Assessment* (product no. 022526kk)
- Audit Risk Alert *Understanding SAS No. 112 and Evaluating Control Deficiencies* (product no. 022536kk)
- *Checklist Supplement and Illustrative Financial Statements for Construction Contractors* (product no. 008928kk)
- *Audit and Accounting Manual* (2007) (product no. 005137kk)
- *Accounting Trends & Techniques, 61st Edition* (product no. 009899kk)

AICPA reSOURCE: Accounting and Auditing Literature

.144 The AICPA has created your core accounting and auditing library online. AICPA reSOURCE is now customizable to suit your preferences or your firm's needs. Or, if you prefer to have access to the entire library, that is available too. Get access—anytime, anywhere—to the AICPA's latest *Professional Standards*, TPAs, Audit and Accounting Guides (more than 20), Audit Risk Alerts (more than 15), and *Accounting Trends & Techniques*. To subscribe to this essential online service for accounting professionals, go to www.cpa2biz.com.

Continuing Professional Education

.145 The AICPA offers a number of continuing professional education (CPE) courses that are valuable to CPAs working in public practice and industry, including the following:

- *AICPA's Annual Accounting and Auditing Update Workshop* (2007 Edition) (product no. 736183kk [text] or 187191 [DVD]). Whether you are in industry or public practice, this course keeps you current and informed and shows you how to apply the most recent standards.
- *SEC Reporting* (product no. 736774kk [text] or 186755 [DVD]). Confidently comply with the latest SEC reporting requirements with this comprehensive course. It clarifies new, difficult, and important reporting and disclosure requirements while giving you examples and tips for ensuring compliance.

.146 Among the many courses, the following are specifically related to the construction industry:

- *Construction Contractors: Accounting Auditing and Tax* (product no. 736431kk). Master the fundamentals of the construction industry with this highly effective course. An outstanding value, it provides a thorough industry overview and includes AICPA authoritative publications. Content is tailored to the needs of both practitioners and industry financial professionals.

- *Construction Contractors Advanced Issues* (product no. 731993kk). Get hands-on advice on the accounting, audit, and tax issues that make the construction industry a high risk client. Address difficult issues such as look back calculations, measuring progress of construction contracts, and overhead allocations. Enhance your skills today to reduce the risk of your next construction engagement.

.147 Visit www.cpa2biz.com for a complete list of CPE courses.

Online CPE

.148 AICPA CPExpress (formerly AICPA InfoBytes), offered exclusively through CPA2Biz.com, is AICPA's flagship online learning product. AICPA CPExpress now offers a free trial subscription to the entire product for up to 30 days. AICPA members pay $149 for a new subscription and $119 for the annual renewal. Nonmembers pay $369 for each. Divided into 1-credit and 2-credit courses that are available 24 hours a day, 7 days a week, AICPA CPExpress offers hundreds of hours of learning in a wide variety of topics. Some topics of special interest to the construction industry include the following:

- *Construction Contractors: Audit Risks in the Construction Industry*
- *Construction Contractors: The Industry and Its Accounting*
- *Construction Contractors: Sureties, Audit Planning and Preliminary Analytical Procedures*

.149 To register or learn more, visit www.cpa2biz.com.

Webcasts

.150 Stay plugged in to what is happening and earn CPE credit right from your desktop. AICPA Webcasts are high quality, two-hour CPE programs that bring you the latest topics from the profession's leading experts. Broadcast live, they allow you to interact with the presenters and join in the discussion. If you cannot make the live event, each Webcast is archived and available on CD-ROM.

CFO Quarterly Roundtable Series

.151 The CFO Quarterly Roundtable Webcast Series, brought to you each calendar quarter, covers a broad array of "hot topics" that successful organizations employ and subjects that are important to the CFO's personal success. From financial reporting and budgeting and forecasting to asset management and operations, the roundtable helps CFOs, treasurers, controllers, and other financial executives excel in their demanding roles.

SEC Quarterly Update Series

.152 The SEC Quarterly Update Webcast Series, brought to you each calendar quarter, showcases the profession's leading experts on what is "hot" at the SEC. From corporate accounting reform legislation and new regulatory initiatives to accounting and reporting requirements and corporate finance activities, these hard-hitting sessions will keep you "plugged in" to what is important. A must for preparers in public companies and practitioners who have public company clients, this is the place to be when it comes to knowing about the areas of current interest at the SEC.

Member Service Center

.153 To order AICPA products, receive information about AICPA activities, and find help on your membership questions, call the AICPA Service Operations Center at (888) 777-7077.

Hotlines

Accounting and Auditing Technical Hotline

.154 Do you have a complex technical question about GAAP, other comprehensive bases of accounting, or other technical matters? If so, use the AICPA's Accounting and Auditing Technical Hotline. AICPA staff will research your question and call you back with the answer. You can reach the Technical Hotline at (888) 777-7077.

Ethics Hotline

.155 In addition to the Technical Hotline, the AICPA also offers an Ethics Hotline. Members of the AICPA's Professional Ethics Team answer inquiries concerning independence and other behavioral issues related to the application of the AICPA *Code of Professional Conduct*. You can reach the Ethics Hotline at (888) 777-7077.

Industry Conference

.156 The National Construction Industry Conference is held in early winter in Las Vegas, NV. This conference is a two-day event for CPAs, CFOs, controllers, and members of the surety industry who serve the construction industry. It provides a national perspective from industry leaders about the latest construction industry trends and recent compliance issues. For further information about the conference, call (888) 777-7077 or visit www.cpa2biz.com.

AICPA CAQ

.157 The CAQ (formerly the Center for Public Company Audit Firms) was created to serve investors, public company auditors, and the markets. The CAQ's mission is to foster confidence in the audit process and to aid investors and the capital markets by advancing constructive suggestions for change rooted in the profession's core values of integrity, objectivity, honesty, and trust.

.158 To accomplish this mission, the CAQ works to make public company audits even more reliable and relevant for investors in a time of growing financial complexity and market globalization. The CAQ also undertakes research, offers recommendations to enhance investor confidence and the vitality of the capital markets, issues technical support for public company auditing professionals, and helps facilitate the public discussion about modernizing business reporting. The CAQ is a voluntary membership center that supports member firms that audit or are interested in auditing public companies with education, communication, representation, and other means. To learn more about the CAQ, visit http://thecaq.aicpa.org.

Industry Web Sites

.159 The Internet covers a vast amount of information that may be valuable to auditors of construction companies, including current industry trends and developments. Some of the more relevant sites for auditors with construction clients include those shown in the appendix of this alert. The construction practices of some of the larger CPA firms may also contain industry-specific auditing and accounting information that is helpful to auditors.

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.160 This Audit Risk Alert replaces *Construction Contractors Industry Developments—2006/07.*

.161 The Audit Risk Alert *Construction Contractors Industry Developments—2007/08* is published annually. As you encounter audit or industry issues that you believe warrant discussion in next year's Audit Risk Alert, please feel free to share them with us. Any other comments that you have about the Audit Risk Alert would also be appreciated. You may e-mail these comments to ccole@aicpa.org or write to:

Christopher Cole, CPA CFE
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220 Leigh Farm Road
Durham, NC 27707-8110

Appendix—Additional Web Resources

.162 Here are some useful Web sites that may provide valuable information to auditors and accountants.

Web Site Name	***Content***	***Web Site***
American Institute of CPAs (AICPA)	Summaries of recent auditing and other professional standards as well as other AICPA activities	www.aicpa.org www.cpa2biz.com
AICPA Accounting Standards Executive Committee (AcSEC)	Issues SOPs, guides, Practice Bulletins containing financial, accounting, and reporting recommendations, among other things	www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+Standards
AICPA Accounting and Review Services Committee (ARSC)	Develops and issues review and compilation standards and interpretations	www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Accounting+and+Review+Services+Committee
AICPA Professional Issues Task Force (PITF)	Accumulates and considers practice issues that appear to present concerns for practitioners and for disseminating information or guidance, as appropriate, in the form of practice alerts	www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Professional+Issues+Task+Force
AICPA Governmental Audit Quality Center (GAQC)	Information and updates on the latest information relating to governmental auditing, particularly for audits performed under *Government Auditing Standards* and OMB Circular A-133	www.aicpa.org/GAQC
Economy.com	Source for analysis, data, forecasts, and information on the United States and world economies	www.economy.com

Web Site Name	*Content*	*Web Site*
The Federal Reserve Board	Key interest rates	www.federalreserve.gov
Financial Accounting Standards Board (FASB)	Summaries of recent accounting pronouncements and other FASB activities	www.fasb.org
USA.gov	Portal through which all government agencies can be accessed	www.usa.gov
Government Accountability Office (GAO)	Policy and guidance materials, reports on federal agency major rules	www.gao.gov
Governmental Accounting Standards Board (GASB)	Summaries of recent accounting pronouncements and other GASB activities	www.gasb.org
General Printing Office Access	Provides links to search the Code of Federal Regulations, Federal Register, and Public Laws	www.access.gpo.gov
International Accounting Standards Board (IASB)	Summaries of International Financial Reporting Standards and International Accounting Standards	www.iasb.org
International Federation of Accountants (IFAC)	Information on standards-setting activities in the international arena	www.ifac.org
Public Company Accounting Oversight Board (PCAOB)	Information on accounting and auditing the activities of the PCAOB and other matters	www.pcaob.org
Securities and Exchange Commission (SEC)	Information on current SEC rulemaking and the EDGAR database	www.sec.gov